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SIPDIS

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SENSITIVE

1E. O. 12958: N/A
TAGS: ECON ETRD EINV PGOV ZI
SUBJECT: Gono Forecasts Economic Growth in 2005

Sensitive but unclassified.

Summary

11. (U) Reserve Bank (RBZ) Governor Gideon Gono was upbeat about the economy's recovery prospects in his quarterly monetary review on October 28, forecasting a 150 percent increase in tobacco production and 3.5-to-5 percent overall economic growth in 2005, as well as single-digit inflation by mid-2006. Despite continuing difficulties faced by the country's beleaguered exporters, Gono offered them only modest relief. Departing from his performance in the past two quarterly reviews, the central banker did not depreciate the zimdollar by establishing a new exchange rate floor price, and he even restricted devaluations over the next quarter to a cumulative and inflation-lagging 10 percent. Still, Gono reduced the percentage of revenue that exporters must surrender at the ultra-low Z\$824:US\$ rate during the all-important 31-90 days following shipment of goods. End summary.

12. (SBU) Gono struck a triumphal pose for much of the speech. "As a nation," he began, "we are beginning to shed tears of joy, reminiscent of a people who have just escaped from the jaws of a lion." While issuing his single-digit inflation forecast, Gono took credit for already driving inflation down from 623 percent in January to a projected 150-160 percent by Dec 31. As for growth, Gono's optimistic projection of 3.5-to-5 percent growth would mark an important turnaround following seven recession years. However, Gono did not explain how the economy would return to positive growth, other than that he believes tobacco output will increase from this year's 65 million to 160 million kgs in 2005. Gono also declared platinum a "strategic mineral," meaning the GOZ will now assume the same middleman role it plays with gold, tobacco and grain, purchasing and reselling all output.

GOZ clings to strong zimdollar

13. (U) Zimbabwe's exporters were disappointed that Gono will maintain a strong zimdollar even as inflation remains in triple digits. The RBZ Governor said he will manage a Z\$5600-6200:US\$ exchange rate band over the next quarter, suggesting a maximum cumulative devaluation of 10 percent through Jan. 31, 2005. This potential devaluation falls short of the GOZ's inflation projection for the next three months, meaning exporters will probably continue to see costs rise faster than revenue.

14. (U) Gono made a concession to exporters by further reducing the portion of revenue they must exchange at Z\$824:US\$, barely one-tenth of the true market rate. Gono announced that the GOZ will continue to exempt exporters from any Z\$824:US\$ exchange requirement if they remit earnings to the RBZ within 30 days of shipment. The RBZ will require that exporters convert only 10 percent (down from 15-25 percent) at the disadvantageous Z\$824:US\$ rate within 31-90 days of shipment, the most common settlement period.

15. (U) Gono offered a continuation of a preferential exchange rate for gold. By boosting the GOZ's support price for gold from Z\$85,000 to 92,000/gram, Gono maintained an effective exchange rate of around Z\$6,800:US\$ for bullion sales to the GOZ. This compares favorably with the Z\$5600:US\$ official rate, but well below the current Z\$8500:US\$ parallel rate. Thanks to the preferential exchange rate, gold will become Zimbabwe's top export this year, surpassing both tobacco and cotton.

Assessment: Are Gono's targets attainable?

16. (SBU) Single-digit inflation: For 2004, it is safe to say the economy has already enjoyed the full disinflation benefits from a zimdollar that has actually strengthened (Z\$6500 to 5600:US\$), while prices will rise by at least 150 percent (using Gono's most optimistic inflation forecast). If he wants to cut inflation to 10 percent in the next 20 months, Gono will have to finally attack its causes (i.e., loose monetary policy, negative real interest rates) rather than an isolated symptom (i.e., exchange rate depreciation). Yet a monetary tightening would probably trigger a painful and unpopular adjustment period where the GOZ will have to cut spending. Gono has shown no inclination to go this route without balance-of-payments support. Even in his lengthy quarterly statements (last Thursday's official transcript was 132 pages), the Governor has never established a target for reigning in monetary expansion, which is still an annualized 321 percent. Over the long haul, GOZ efforts to keep inflation in check through an increasingly overvalued exchange rate are unsustainable, but Gono has indicated he will stick to this policy through March's parliamentary elections. The ruling ZANU-PF clearly wants to tout Zimbabwe's falling inflation in its election campaign.

17. (SBU) Tobacco Output of 160 million kgs in 2005: We have not encountered a single tobacco industry insider, including those at the GOZ's own Tobacco Industry Marketing Board (TIMB), who believes production can rebound from this year's 65 to 160 million kgs in 2005. Based on a count of seedbeds for irrigated tobacco crops already in the ground, the most optimistic forecast we have heard is 80 million kgs. Through fast-track land reform, the GOZ has resettled small-scale farmers on many large tobacco farms. Since these new occupants generally lack the expertise, infrastructure and resources to grow tobacco, it is unclear who the GOZ believes would supply the additional 95 million kgs.

18. (SBU) 3.5-to-5 Percent Economic Growth in 2005: Other than by restoring tobacco output, Gono did not spell out what would cause this strong growth. (Note: The local IMF office told us the lending agency had withdrawn its 5 percent 2005 growth forecast for Zimbabwe. The IMF will make a new forecast after a November visit.) Without a rebound in exports, the economy's traditional engine, it is hard to imagine such a dynamic economic expansion next year. Gono shows no sign of softening his commitment to an overvalued zimdollar, a policy that punishes exporters. In his remarks, Gono was unwavering. He characterized the inflation-lagging devaluation from Z\$5600 to 6200:US\$ over the next three months as a "relaxation [that] should be viewed in the spirit of Christmas, which is traditionally a period of giving and magnanimity" and insisted that exporters should not expect "that each time the Central Bank reviews its monetary policy, the diaspora floor price will be reviewed upwards." Many exporters are surviving only through the RBZ's productive sector loan facility, which provides cash at interest rates that are heavily negative in real terms. Given Gono's fervent belief in a stable zimdollar even at a time of triple-digit inflation, exporters will be ill equipped to lead the growth charge.